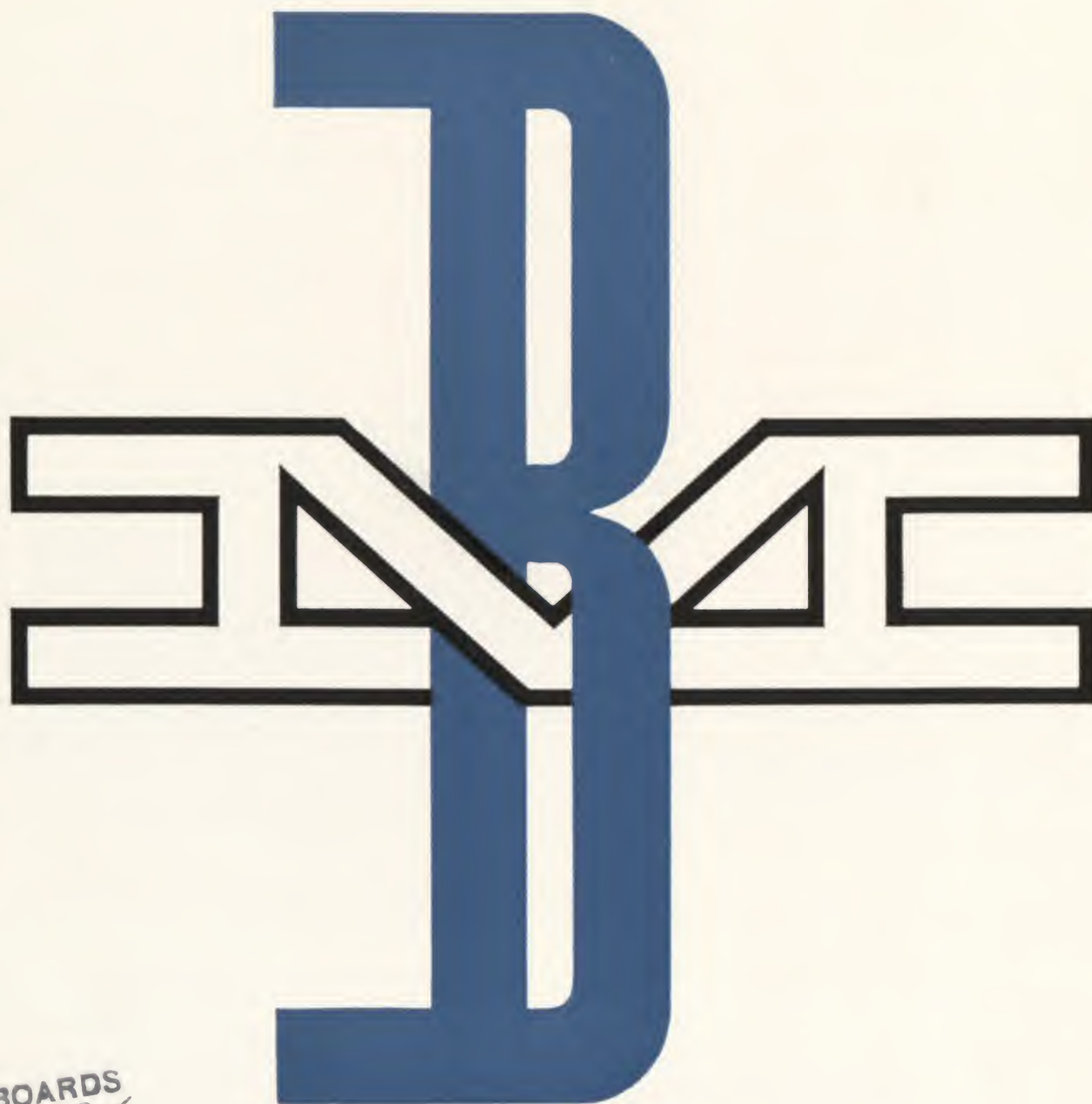


BOSTON AND MAINE CORPORATION



BOARDS

DRB
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133rd ANNUAL REPORT 1965



THOROLD S. CURTIS

TREASURER
BOSTON AND MAINE RAILROAD

150 CAUSEWAY STREET
BOSTON 14, MASS.



BOARD OF DIRECTORS

JAMES A. ARDOLINO, Medford, Mass.
ANDREW J. BECK, Presque Isle, Maine
DANIEL A. BENSON, Marblehead, Mass.
DEAN N. BOYLAN, Milton, Mass.
ANTHONY R. CATALDO, Lexington, Mass.
SAMUEL COHEN, Miami Beach, Fla.
EMMET J. KELLEY, Berlin, N. H.
PATRICK J. MULLANEY, Winchester, Mass.
RALPH W. PICKARD, Boston, Mass.
FRANCIS J. REARDON, Lexington, Mass.
SAMUEL RESNIC, Holyoke, Mass.
GEORGE H. SEAL, Marblehead, Mass.
LEE P. STACK, Hingham, Mass.
ALFRED SWEENEY, Auburn, Maine

Executive Committee—Chairman: MR. STACK; Vice Chairman: MR. RESNIC;
Members: MESSRS. BENSON, CATALDO, PICKARD, REARDON, SEAL and
SWEENEY.

OFFICERS

DANIEL A. BENSON, President and Chief Executive Officer
RALPH W. PICKARD, First Vice President
PATRICK J. MULLANEY, Vice President-Traffic
WILFRED H. HOLLAND, Vice President-Operations
E. FRANKLIN REED, Vice President-Industrial Development
RICHARD J. MULHERN, General Counsel
THOROLD S. CURTIS, Treasurer
HARRY BLAKE, Secretary
PAUL C. DUNN, Chief Mechanical Officer
WHITCOMB HAYNES, General Manager
CHARLES F. YARDLEY, General Manager-Piggyback

TRANSFER AGENTS

Old Colony Trust Company, 45 Milk Street, Boston
Manufacturers Hanover Trust Company, One Whitehall Street,
New York

As of March 1, 1966



DANIEL A. BENSON

President's Report

In 1965 the Boston and Maine achieved its best financial results since the year 1957, sharply reducing its losses by \$4,663,034 from the deficit of 1964.

For the 12-month period ending December 31, 1965, the consolidated net loss was \$594,711. In the same 12-month period of 1964 the net loss, also on a consolidated basis, was \$5,257,745. Significantly, the gains of 1965 were accompanied by an improvement of \$5,898,633 in the Corporation's working capital position. It is also important to note that the 1965 results were achieved despite the absorption of a net increase of \$531,760 in wage and fringe benefit costs necessitated by national settlements reached with the railroad

brotherhoods.

The results for 1965 do not reflect a special credit of \$678,338 resulting from negotiated settlements of real estate taxes plus accrued interest for 1964 and prior years. Neither does the income account reflect an additional special credit of \$565,738 arising from settlements of liabilities for freight car rentals with other railroads.

Exclusion of the tax settlements from the income account for 1965 was necessitated by a recent ruling of the Interstate Commerce Commission that the amounts involved could not be included as net income, as had been the practice in prior years, but should be credited directly to retained income.

Operating revenues in 1965 were \$64,825,795 as compared with \$63,373,660 in 1964, an increase of \$1,452,135. Operating expenses were \$49,525,585 as against \$52,974,756 in 1964, a decrease of \$3,449,171. For several years, the Boston and Maine's operating ratio, i.e., the percentage of operating expenses to operating revenues has been the best among the New England lines and has enjoyed a creditable standing among the major Class I railroads in the country. In 1965, the operating ratio was 76.40%.

The principal factor in the Corporation's improved performance in 1965 was the elimination of substantially all of the passenger net railway operating deficit that had persisted for 20 consecutive years. Although contract payments from the Massachusetts Bay Transportation Authority did not commence until January 25, 1965, they totaled \$3,072,764 for the year. The significance of this figure can be seen when it is recalled that in 1964 the loss from passenger operations was \$3,254,078.

It is particularly noteworthy that progress towards elimination of losses from passenger operations was accompanied by improvement of the Corporation's financial position in two additional areas of major importance.

Long-term debt was reduced by \$3,913,235.

Property tax indebtedness was reduced by \$1,975,799.

There follows a review of developments of the past year and comment on the outlook for the year ahead:

ICC HEARINGS

By Order of the Interstate Commerce Commission, hearings will be held in Wash-

ington, D. C., beginning April 20, 1966, for inclusion of the Boston and Maine into the Norfolk and Western Railway System.

PASSENGER OPERATIONS

"If rail passenger service is a public necessity that cannot be supported by private enterprise then public means for its support will have to be found. We believe it to be in the public interest to make it plain that if passenger deficits continue, the basic needs of financial survival will leave the B&M no choice but to consider such measures as are open to it to divest itself of the passenger deficit." . . .

President's letter to Stockholders, 130th Annual Report of the Boston and Maine Railroad, 1962.

The foregoing statement was issued by your Management immediately after the B&M entered into an agreement with the Mass Transportation Commission of Massachusetts for a one-year transit demonstration program in 1963.

Throughout the course of the experiment, Management called public attention to the net deficit results on an avoidable cost basis, which confirmed the B&M's position as to the deficit nature of its passenger service. On December 8, 1963, the B&M announced that upon termination of its agreement with the Mass Transportation Commission the Railroad would petition for complete discontinuance of passenger operations in and out of Boston. A petition was filed on January 6, 1964, immediately after expiration of the B&M agreement with the Mass Transportation Commission.

In its final report on the one-year experiment conducted by the B&M, the Mass Transporta-

tion Commission acknowledged that "The B&M cannot afford the present cash drain from its commutation service." Reporting its conclusions, the Commission also said: "These findings point to the need for outside support of the B&M passenger service if it is to remain in operation."

This judgment was echoed by the Massachusetts legislature, which passed a mass transportation act establishing a state transportation authority empowered to subsidize commuter carrying railroads in the Boston area for a minimum period of three years.

Hearings on the B&M petitions were held by the ICC in October, 1964, in Boston and two cities of New Hampshire. The case presented by the B&M emphasized the findings of the Mass Transportation Commission as to the deficit character of the passenger operations. At the same time, the B&M pointed out, assumption by the state authority of all responsibility for mass transit operations would assure adequate service to rail commuters while at the same time enabling the B&M to maintain its essential freight services to New England's commerce and industry.

Under an Order issued by the ICC on January 15, 1965, the B&M was authorized to discontinue all passenger operations in Massachusetts in and out of Boston. This service is now being performed under contract with the Massachusetts Bay Transportation Authority. Upon termination of this contract, the B&M will be relieved of all obligation to operate passenger service intrastate in Massachusetts.

In an Order issued December 31, 1964, the ICC authorized the B&M to discontinue all interstate passenger operations in and out of Boston, with the exception of one daily round

trip between Boston and Concord, N. H.; one daily round trip between Boston and Dover, N. H.; and the Boston-to-Newburyport portion of two trains formerly operated between Boston and Portsmouth, N. H.

On December 30, 1965, the Boston and Maine filed statements relating to the proposed discontinuance of these remaining trains. Hearings on the B&M case will commence in Boston on March 7.

On February 1, 1966, the B&M filed statements related to the proposed discontinuance of four trains operated on the Connecticut River line. These trains are the B&M segments of New York-to-Montreal trains, previously petitioned for discontinuance by the New Haven Railroad. This case is also scheduled to be heard on March 7.

On March 2, 1966, the State of New Hampshire agreed to withdraw its protests in all pending actions involving discontinuance of B&M passenger operations. For its part, the Boston and Maine agreed to continue operation of present passenger service between Boston and Dover, N. H., and between Boston and Concord, N. H., through June 30, 1967.

The extension will afford the New Hampshire legislature adequate time to determine what requirements exist for passenger service and to consider such steps as may be appropriate to subsidize the service after June 30, 1967. The agreement will enable the Boston and Maine to effect substantial savings in legal fees that would otherwise have been necessary to contest appeals brought by New Hampshire in Federal courts. Equally important, when the ICC begins hearings on the B&M's petition for discontinuance of its remaining interstate passenger service, the

case will proceed without the major opposition of the State of New Hampshire.

FREIGHT SERVICE

Consolidated freight revenues of \$53,562,697 increased slightly from \$53,541,800 in 1964.

The character of B&M's traffic reflected generally good business conditions in the New England area. B&M territory, particularly in the Boston area, is the scene of extensive current and projected construction activity, involving movements of steel, cement and other high revenue traffic. The B&M also continues to handle, in volume, bulk commodities such as bituminous coal, salt, feed and grain products.

New England's paper mills are all operating at, or near, capacity. Expansion or rehabilitation of existing plants are being reflected in increased tonnages, and it is anticipated that the volume of paper traffic handled by the B&M will continue to grow.

A source of continuing encouragement is that car revenue figures are showing a rising trend. In the area served by the B&M the railroad industry is showing increases in its share of the total traffic. Incentive rates, trainload rates, expansion of piggyback operations, along with heavier loadings per car, coupled with reductions in operating costs, and new and better marketing techniques should all result in an improvement in gross, as well as net freight revenue figures.

PIGGYBACK SERVICE

Trailer-on-flat-car volume and revenue continued in 1965 the rising trend shown since the inception of this service on the Boston and

Maine. Gross piggyback revenue for the year was \$3,257,044 an increase of 12% over 1964.

Year-end 1965 developments, particularly in connection with added provisions for the movement of transcontinental traffic, are expected to contribute to further market expansion and increased piggyback business in 1966. It is anticipated that the year ahead will see increased motor common carrier traffic in piggyback, coast to coast, and increased activity in rail-billed fruit and vegetable traffic eastward from the California growers, as well as westward movements of manufactured and miscellaneous products from the New England area to the Pacific Coast.

The B&M acquired 265 new piggyback trailers in 1965, bringing its present fleet up to 833 units. This will facilitate the B&M's ability to keep pace with the continuing growth trend of piggyback transportation in the railroad industry.

PER DIEM

As noted in previous Annual Reports, freight car rentals pose a major problem to terminating railroads such as the B&M. Long standing litigation on this issue yielded two encouraging results in 1965.

Through negotiation, the Corporation settled all past per diem liability with two trunk lines and three smaller railroads. This eliminated \$922,124 of accrued liability and resulted in a special credit to Retained Income of \$565,738.

More recently, a proposed Examiner's report in Interstate Commerce Commission proceedings on the per diem issue recommended for adoption many of the principles long

urged by the B&M. In addition, a number of the trunk line carriers are now aligned, at least in part, with the B&M in its contention that the formula used by large car owning railroads in arriving at car rental rates does not afford adequate protection for terminating railroads. While pressing for relief, the Boston and Maine is continuing its established scale of freight car rental payments and pursuing efforts to settle past per diem claims by negotiation.

SALES OF PROPERTY

In 1965 the Management continued to pursue aggressively the program for disposition of real estate not essential to freight operations. Particular efforts were concentrated on substantial areas in the Boston metropolitan district. High property valuations and increasing tax rates in this area offered opportunities to reduce operating expenses and generate cash. Among many individual transactions aimed at these objectives, two of major importance are especially noteworthy.

In December, 1965, all remaining property south of the Charles River in Boston—the North Station passenger facility—was sold for \$3,413,195, reducing tax accruals for 1966 and subsequent years by \$559,579 at present rates.

Rearrangement of freight operations permitted abandonment of one of the two retarder freight classification facilities at Somerville (Yard 9), and of much of the land area comprising the other facility (Yard 8), including the so-called “tear drop,” a vacant area of 20 acres theretofore inaccessible because of surrounding tracks. The Board of Directors authorized acceptance of an offer of \$1,685,000 for these properties, the highest bid received.

Complete disposition of this property is anticipated within the next 18 months. At present tax rates and valuations, the Boston and Maine will benefit by \$245,000 in reduction of real estate tax accruals.

IMPROVEMENTS

Capital expenditures for road property and equipment in 1965 were \$1,906,042.

Plant maintenance included resurfacing 258 single track miles of stone ballasted main track. New and relay rail laid during the year totaled 3,560 tons, compared with 1,200 tons in 1964; while 46,000 cross ties (new and relay) were installed in 1965, as against 35,000 ties installed in the preceding year. These advances reflected in 1965 the increased productivity made possible by the addition of new work equipment and roadway machines in 1964.

As part of a continuing program to improve the efficiency and economy of crossing protection, installation of electric gates in 1965 resulted in annual savings of \$21,333. One of a number of Centralized Traffic Control projects during the year resulted in the retirement of a Tower with annual savings of \$30,470, while an annual saving of \$24,000 was made possible by the installation of an automatically operated switch at the entrance to an engine house.

Among general facility improvements undertaken during the year, a project involving improvement of clearances in the B&M's tunnel at Bellows Falls, Vt., attracted attention throughout the railroad industry because it utilized for the first time on any railroad a process developed for use in quarrying operations.

The Bellows Falls tunnel project helped to safeguard the B&M's high revenue newsprint traffic. More important, however, it was part of a continuing program to improve clearances that will enable the B&M to compete for low deck tri-level cars and other special equipment of high capacity nature now in growing use in rail-borne traffic.

Additional units of work equipment and roadway machines were purchased during the year at a capital cost of \$202,000 and are expected to contribute to the continuing objectives of economy and productivity.

INDUSTRIAL DEVELOPMENT

Completion of new and expanded industrial plant facilities on the Boston and Maine during 1965 involved some 1,069,000 sq. ft. of space together with the installation of 8,400 feet of track. Projects now under construction or in final planning stages include an additional 1,279,000 sq. ft. expected to be completed during the current year.

New and expanded industries located on the Boston and Maine during 1965 are expected to produce rail traffic at the rate of 8,000 cars annually. Plants programmed for completion in 1966 should increase this volume by 6,000 cars.

New plant construction included manufacturing and warehousing facilities. The outlook for 1966 is extremely bright with construction already started or proposed for early spring involving among others:

General Telephone and Telegraph (Sylvania)—a new 175,000 sq. ft. warehouse at Danvers, Mass.

McCord Corporation (Davidson Rubber Co.)—a new 73,000 sq. ft. manufacturing plant at Farmington, N. H.

Buy-Rite Wholesale Grocers—a new 318,000 sq. ft. warehouse at Salem, N. H.

Food Center Wholesale Grocers—a 72,000 sq. ft. additional warehouse facility at Charlestown, Mass.

New England Grocers Supply—68,000 sq. ft. of additional warehouse space at Worcester, Mass.

Process Engineering—a 144,000 sq. ft. manufacturing facility at Plaistow, N. H.

LONG-TERM DEBT CHANGES

The Boston and Maine met substantial obligations for equipment and road property in 1965. This resulted in a net reduction in long-term debt of \$3,913,235 as reflected in the following table:

Balance at beginning of year \$ 89,639,243

Increases:

Series TT 6% Bonds issued (Bond Exchange Plan)	46,517,080
Equipment and Road Property obligations for new acquisitions	170,146
Collateral Note	500,000
	<u>\$136,826,469</u>

Decreases:

Series SS 6% Bonds retired (Bond Exchange Plan)	\$ 44,093,080
Series AC 5% Bonds retired (Bond Exchange Plan)	2,424,000
Series SS Script matured, etc.	43,184
Equipment and Road Property obligations paid	3,499,900
Principal payments made on Collateral Trust Indentures and Collateral Note	1,040,297
	<u>51,100,461</u>

Balance at end of year \$ 85,726,008

EMPLOYEE RELATIONS

In early 1965 those wage and rules demands which had not been settled in late 1964 were settled on a basis of the pattern which had been established earlier with the other organizations.

On February 7, 1965, the Carriers entered into a national Job Stabilization Agreement with the major non-operating unions other than the shop craft unions who had settled earlier as referred to in last year's report. The agreement permits the railroad to make technological, operational and organizational changes in consideration for certain assurances to affected employees as to job security and severance allowances. Because the B&M's forces had been gradually reduced in the years preceding this agreement, it is not expected that any substantial financial liability will be incurred as a result of the Agreement.

The Brotherhood of Railroad Trainmen, anticipating the end of the two-year moratorium period set by Public Law 88-108, has filed notice of its desire to negotiate a crew consist rule which would require the employment of a conductor and two trainmen on all trains.

While the notice is considered to be premature, appropriate counterproposals have been served and at present the matter is in mediation.

During the year many freight and yard assignments were run without the presence of a locomotive fireman as permitted by the Award of Arbitration Board No. 282. This, of course, has resulted in a considerable saving in wage costs to the Company. On November 15 the Brotherhood of Locomotive Firemen and Enginemen served notice under the Railway Labor Act requesting restoration of all dismissed firemen and that firemen be used on all assignments in the future except some very few yard switchers and branch line freight trains. The requests have been rejected, and while at year's end the organization had taken no further steps to progress this matter, it is expected to do so early in 1966.

A FINAL NOTE

The Boston and Maine is grateful to its employees for their excellent performance and cooperation during the year.

FINANCIAL STATEMENTS

as of December 31, 1965

**BOSTON AND MAINE CORPORATION
AND CONSOLIDATED SUBSIDIARIES**

ASSETS

	<i>December 31</i>	
	<u>1965</u>	<u>1964</u>
CURRENT ASSETS:		
Cash	\$ 2,154,309	\$ 1,886,863
Marketable securities, at cost (approximate market)	1,131,557	615,447
Special deposits	794,544	125,979
Accounts and notes receivable	4,951,410	4,800,464
Inventories of materials and supplies, at cost	3,111,952	2,947,668
Prepayments and other current assets	425,644	480,857
TOTAL CURRENT ASSETS	<u>\$ 12,569,416</u>	<u>\$ 10,857,278</u>
 PROPERTIES (NOTE 2):		
Roadway and structures, including improvements to leased properties—\$14,715,651 in 1965, \$14,593,836 in 1964	\$175,395,035	\$181,477,664
Equipment	69,716,472	72,982,313
	<u>\$245,111,507</u>	<u>\$254,459,977</u>
 LESS:		
Depreciation of roadway and structures	(5,588,911)	(8,356,039)
Depreciation of equipment	(26,728,342)	(25,756,962)
	<u>\$212,794,254</u>	<u>\$220,346,976</u>
 Miscellaneous physical properties, less depreciation—\$112,158 in 1965, \$293,549 in 1964	3,623,571	3,771,263
	<u>\$216,417,825</u>	<u>\$224,118,239</u>
 INVESTMENTS AND OTHER ASSETS:		
Investments in leased lines (Page 13 and Note 1)	\$ 3,588,349	\$ 3,567,943
Other investments (Page 14)	1,372,842	2,567,439
Deposits with trustees for first mortgage bonds and equipment obligations	2,266,104	104,707
Other assets and deferred charges	2,840,264	2,196,033
	<u>\$ 10,067,559</u>	<u>\$ 8,436,122</u>
	<u>\$239,054,800</u>	<u>\$243,411,639</u>

BALANCE SHEET

LIABILITIES AND CAPITAL

	<i>December 31</i>	
	<i>1965</i>	<i>1964</i>
CURRENT LIABILITIES:		
Accounts payable	\$ 8,148,857	\$ 9,746,794
Accrued vacation pay	1,642,748	1,997,737
Accrued interest	1,407,946	1,434,332
State and local taxes	2,903,342	4,900,735
Estimated current portion of injury and damage claims	1,336,309	1,546,099
TOTAL CURRENT LIABILITIES (excluding long-term debt due within one year)	\$ 15,439,202	\$ 19,625,697
 LONG-TERM DEBT DUE WITHIN ONE YEAR (Page 14):		
First mortgage bonds, equipment and other obligations	\$ 5,214,631	\$ 4,459,258
 LONG-TERM DEBT (Page 14):		
First mortgage bonds	\$ 46,341,804	\$ 46,560,264
Income mortgage bonds	18,703,500	18,703,500
Equipment and other obligations	15,466,073	19,916,221
	\$ 80,511,377	\$ 85,179,985
 OTHER LIABILITIES AND DEFERRED CREDITS:		
Provision for disputed per diem charges (Note 4)	\$ 10,849,210	\$ 10,712,326
Provision for injury and damage claims	1,186,656	1,259,112
Accrued depreciation on leased property and liabilities to leased lines	4,185,869	4,013,966
Unearned interest accrued on income mortgage bonds	5,985,120	5,236,980
Other	2,386,342	1,640,288
	\$ 24,593,197	\$ 22,862,672
 CAPITAL AND RETAINED INCOME:		
Capital stock (Note 5):		
5% Preferred stock, \$100 par value:		
Authorized and issued—179,458 shares in 1965, 239,071 shares in 1964	\$ 17,945,800	\$ 23,907,100
Common stock, \$1 par value:		
Authorized—4,000,000 shares		
Issued—704,518 shares in 1965, 589,570 shares in 1964	704,518	589,570
Additional capital (Note 5)	90,310,505	84,376,019
Retained income (Page 13 and Note 6)	4,335,570	2,411,338
	\$113,296,393	\$111,284,027
Contingent obligations and commitments (Note 8)	\$239,054,800	\$243,411,639

BOSTON AND MAINE CORPORATION AND CONSOLIDATED SUBSIDIARIES
STATEMENT OF INCOME

	<i>Year ended December 31</i>	
	<i>1965</i>	<i>1964</i>
OPERATING REVENUES:		
Freight	\$ 53,562,697	\$ 53,541,800
Passenger	4,046,463	5,270,323
Other (including passenger service contract payments—\$3,072,764 in 1965, \$322,308 in 1964) (Note 7)	7,216,635	4,561,537
	<u>\$ 64,825,795</u>	<u>\$ 63,373,660</u>
OPERATING EXPENSES:		
Transportation	\$ 28,166,703	\$ 30,620,996
Maintenance of way and structures	7,705,578	7,745,373
Maintenance of equipment	8,711,048	9,370,681
Traffic, general and miscellaneous expenses	4,942,256	5,237,706
	<u>\$ 49,525,585</u>	<u>\$ 52,974,756</u>
NET REVENUE FROM OPERATIONS	<u>\$ 15,300,210</u>	<u>\$ 10,398,904</u>
OTHER OPERATING CHARGES:		
Payroll, property and state excise taxes, etc.	\$ 4,912,491	\$ 4,917,305
Net rents for equipment and joint facilities	5,441,212	5,415,894
	<u>\$ 10,353,703</u>	<u>\$ 10,333,199</u>
NET OPERATING INCOME	\$ 4,946,507	\$ 65,705
NONOPERATING INCOME (EXPENSE)—NET	<u>(305,747)</u>	<u>17,343</u>
NET INCOME BEFORE FIXED CHARGES AND CONTINGENT INTEREST	<u>\$ 4,640,760</u>	<u>\$ 83,048</u>
FIXED CHARGES:		
Rent for leased lines, etc.	\$ 452,374	\$ 448,239
Interest:		
First mortgage bonds	2,765,262	2,795,900
Equipment trust certificates	386,095	448,705
Conditional sale contracts	362,505	411,393
Guaranteed notes and other	364,980	389,056
Amortization of long-term debt expense	156,115	99,360
	<u>\$ 4,487,331</u>	<u>\$ 4,592,653</u>
NET INCOME (LOSS) BEFORE CONTINGENT INTEREST	\$ 153,429	\$ (4,509,605)
Contingent interest	<u>748,140</u>	<u>748,140</u>
NET LOSS	<u>\$ (594,711)</u>	<u>\$ (5,257,745)</u>
SPECIAL CREDITS:		
Abatement of property taxes and related interest	\$ 678,338	—
Settlements of disputed per diem (NOTE 4)	565,738	—
TOTAL OF NET LOSS AND SPECIAL CREDITS	<u>\$ 649,365</u>	<u>\$ (5,257,745)</u>

BOSTON AND MAINE CORPORATION AND CONSOLIDATED SUBSIDIARIES
STATEMENT OF RETAINED INCOME

	<i>Year ended December 31</i>	
	<u>1965</u>	<u>1964</u>
BALANCE AT BEGINNING OF YEAR	\$ 2,411,338	\$ 7,535,000
ADDITIONS (DEDUCTIONS) FOR THE YEAR:		
Net loss	(594,711)	(5,257,745)
Special credits:		
Abatement of property taxes and related interest	678,338	—
Settlements of disputed per diem (NOTE 4)	565,738	—
Net gain on disposal of land	1,608,848	280,317
Losses on track retirements	(333,981)	(200,618)
Other	—	54,384
BALANCE AT END OF YEAR	<u>\$ 4,335,570</u>	<u>\$ 2,411,338</u>

Net gain on disposal of land in 1965 includes a gain of approximately \$1,500,000 on the sale of North Station land. The excess of the amount realized on sale of the North Station terminal building over its original cost, less

accumulated depreciation, amounting to approximately \$1,900,000, was charged in 1965 to the reserve for depreciation of roadway and structures.

STATEMENT OF INVESTMENTS IN LEASED LINES
DECEMBER 31, 1965

	<i>No. of shares owned</i>	<i>% owned</i>	<i>Cost</i>	<i>Boston and Maine equity in book value of underlying net assets</i>	<i>Approximate value based on current market quotations</i>
Northern Railroad ..	20,605	67.2	\$ 2,117,457	\$ 2,118,943	\$ 1,628,000
Stony Brook Railroad	1,829	61.0	151,015	191,038	130,000
Vermont & Massachusetts Railroad	11,647	36.5	1,319,877	2,044,356	1,037,000
			<u>\$ 3,588,349</u>	<u>\$ 4,354,337</u>	<u>\$ 2,795,000</u>

The shares in leased line companies have been acquired over the period from 1937 to 1965. At December 31, 1965 all of the shares were pledged to secure long-term debt. Annual rentals of the leased lines, under long-term leases, amount to approximately \$405,000 plus certain federal and state taxes of the leased line companies which currently aggregate about \$190,000 per year. Dividends

received from the leased line companies amounted to \$200,000 in 1965 and 1964. Since the leased line companies distribute on a current basis substantially all of their net income as dividends, the book values of the underlying net assets of each company have remained approximately the same during the period Boston and Maine has acquired shares in the companies.

BOSTON AND MAINE CORPORATION AND CONSOLIDATED SUBSIDIARIES

STATEMENT OF LONG-TERM DEBT

DECEMBER 31, 1965

	Portion due	
	Within one year (a)	After one year (a)
FIRST MORTGAGE BONDS, Series TT, 6% due August 1, 1967 (b)	\$ 175,276	\$ 46,341,804
INCOME MORTGAGE BONDS, Series A, 4½% (4% cumulative), due July 1970 (c)	—	\$ 18,703,500
EQUIPMENT AND OTHER OBLIGATIONS:		
Equipment Trust Certificates, Series 1, 4½% to 6% due March 1971 secured by equipment of an aggregate original cost of \$22,435,000	\$ 1,234,000(d)	\$ 6,170,000
Guaranteed Notes 4½% to 5% due to 1977 secured by \$1,752,600 principal amount of Series TT bonds, capital stock of leased lines, capital stock and notes of certain wholly- owned subsidiary companies and "other investments" carried at cost of \$175,623	1,566,667	4,933,333(e)
Conditional sale contracts and mortgage notes maturing at vari- ous dates from 1966 to 1990 secured by equipment and real estate of an aggregate original cost of \$16,594,000 and "other investments" carried at cost of \$665,058	2,238,688	4,362,740(e)
	\$ 5,039,355	\$ 15,466,073
	\$ 5,214,631	\$ 80,511,377

(a) Amounts outstanding are exclusive of bonds owned by the companies—\$1,752,600 of Series TT bonds pledged against guaranteed notes and \$559,000 of income mortgage bonds which are unpledged.

(b) The first mortgage bonds are secured by substantially all the road properties and equipment of the company, its operating franchises, leases and agreements subject to the prior lien of equipment trust obligations and conditional sale contracts in the case of certain property and equipment as indicated in the statement above. Interest is payable semiannually at the indicated rate. The first mortgage bonds are entitled to the benefit of a sinking fund provision under which the company is required annually on or before May 1, to deposit with the trustee cash equal to the lesser of (a) 1% of the outstanding TT bonds or (b) net income of the railroad before contingent interest minus "net income deficit", as defined, subsequent to 1964. Under the terms of the sinking fund provision \$175,276 will be payable on May 1, 1966 to the trustee of the first mortgage bonds. Under the terms of the indenture the maturity

of the first mortgage bonds may upon approval of holders of seventy five per cent of the outstanding bonds, be extended up to July 1, 1970.

(c) The income mortgage bonds are secured by a second mortgage on the same properties as those securing the first mortgage bonds. Interest is payable at the rate of 4½% per annum if "available net income" is sufficient and, if not earned, is cumulative and payable not later than the maturity of the bonds at the rate of 4% per annum. The income mortgage bonds are entitled to the benefit of a sinking fund provision under which the company is required annually, on or before September 1, to deposit with the trustee \$482,870 in cash or Series A bonds (at the lesser of their principal amount plus accrued interest, or their cost to the company) if "available net income" is sufficient. There has been no sinking fund obligation since 1958.

(d) The same amount matures within each subsequent year to maturity.

(e) Payable at varying amounts each year to maturity.

NOTES TO FINANCIAL STATEMENTS

Note 1—Basis of Consolidation

The accompanying financial statements include the accounts of Boston and Maine Corporation and those of its wholly-owned subsidiary companies. The company's investments in unconsolidated leased line companies which are less than wholly-owned are summarized on page 13.

Note 2—Properties

The amounts shown in the balance sheet for properties represent, for the most part, the aggregate of acquisitions and additions (by merger, purchase, construction or otherwise), less retirements, recorded under the system of accounting prescribed by the Interstate Commerce Commis-

sion. In accordance with such accounting requirements the company commenced providing for depreciation on roadway and structures (other than properties such as rail, ties, ballast and other track materials) on January 1, 1943. The cost of equipment has been subjected to a systematic policy of depreciation since it was acquired. The recorded cost, less salvage, of all depreciable properties retired is charged to the depreciation reserves.

With respect to rails, ties, ballast and other track materials, included in the roadway accounts in the amount of approximately \$41,700,000 at December 31, 1965, the company follows the prescribed practice of "replacement" accounting. For many years this accounting practice has been considered an acceptable alternative in the railroad industry to the more widespread practice of depreciation accounting. Under this practice replacements in kind are charged to maintenance expense and only improvements and additions are capitalized. The amounts capitalized are not depreciated. Retirements of such properties, less salvage, are also charged to maintenance expense, except that in recent years certain retirements which were considered abnormal have been charged direct to retained income. Gains and losses on disposals of land are credited or charged to retained income.

The accompanying statement of income includes charges for depreciation totaling \$4,611,000 in 1965 and \$4,591,000 in 1964.

Note 3—Federal Income Taxes

As of December 31, 1965, the companies had loss carry-overs for federal income tax purposes aggregating approximately \$42,000,000 which would be available to apply against income in varying amounts through the year 1972.

Note 4—Provision for Disputed Per Diem Charges

The company is party to a dispute with other railroads over per diem rates for car rentals. For various reasons, including its situation as a so-called terminal line, the company incurs more rentals than it earns. Since August, 1953, payment has been made to other railroads at rates which are less than the rates adopted by the Association of American Railroads although full provision has been made on the books at the adopted rates, all by charges against income. During 1965 the company and several other railroads entered into final and conclusive settlements of their per diem disputes. The company settled \$922,124 of its disputed liability for \$356,386 resulting in a special credit to retained income of \$565,738. The terms of the settlements provide that charges subsequent to December 31, 1964 will be settled in full at a rate which is less than the approved industry rate. In 1965, per diem expense has been recorded at the lower rate for cars owned by railroads with which the company has settled. The provision for per diem charges relating to open disputes amounted to \$10,849,210 as of December 31, 1965. The excess of amounts accrued and charged to in-

come over payments, exclusive of the \$356,386 mentioned above, amounted to \$1,059,008 in 1965 and \$1,050,446 in 1964.

Note 5—Capital Stock, Stock Options and Additional Capital

The 5% preferred stock is redeemable at any time at \$100 per share plus accumulated unpaid dividends and is convertible at the option of the holder into common stock at the rate of 1½ shares of common stock for each share of preferred stock. Additional capital was increased by \$5,856,977 in 1965 in connection with the conversion of 59,613 shares of preferred stock into 104,323 shares of common stock.

Dividends on preferred stock, if not paid, are cumulative only if and to the extent (not exceeding 5% per annum) that earnings are available. On this basis there were no cumulative unpaid dividends at December 31, 1965. If earnings are sufficient, the company is required to set aside annually one half of one per cent of the par value of the authorized preferred stock as a sinking fund for redemption of preferred stock, before dividends are paid on the common stock. There was no cumulative sinking fund obligation as at December 31, 1965.

At December 31, 1964 there were outstanding options granted to certain employees to purchase 28,041 shares of common stock of the company at prices ranging from \$6 to \$16 per share or an aggregate of \$288,000. During the year options for 10,625 shares were exercised and the \$77,509 excess of the proceeds over the par value of such shares was credited to additional capital. The company's stock option plans were amended in 1965, subject to the approval of the Interstate Commerce Commission, to conform with the qualified stock option requirements of the Internal Revenue Code. Options for 37,525 shares were granted during the year under the amended plans at prices ranging from \$15.13 to \$19.38 per share. Options for 788 shares were terminated during the year. At December 31, 1965 there were outstanding options to purchase 54,153 shares at \$6 to \$19.38 per share or an aggregate of \$803,000 of which options for 15,949 shares were then exercisable at an aggregate of \$185,000. Under the present stock option plans, further options for 177 shares could be granted to key supervisory personnel at the fair market value at the time of the grant. Options generally become exercisable in instalments over a four year period and remain exercisable during the fifth year after the date of the grant (until the tenth year for options granted prior to 1965).

Note 6—Restrictions on Dividends and Additional Borrowings

The indentures securing the first mortgage bonds, the income mortgage bonds and the guaranteed notes contain various restrictive provisions under which, at December 31, 1965, the company could not pay dividends on or make purchases of any class of its capital stock. The

indenture securing the first mortgage bonds also contains restrictions on additional borrowings.

Note 7—Passenger Service

The company is obligated to continue certain passenger service within a twenty mile radius of Boston under a three-year contract with Massachusetts Bay Transportation Authority, starting in January 1965 and renewable for two years. The contract provides generally that the company will be reimbursed for the excess of passenger service expenses, as defined in the contract, over passenger service revenues and includes options for the Authority to lease or purchase passenger rights of way and passenger equipment at prices to be determined upon exercise of the options.

Note 8—Contingent Obligations and Commitments

In addition to the matters referred to elsewhere in the financial statements and notes, the company had the following contingent obligations and commitments at December 31, 1965:

The company rents approximately 1700 freight cars and 413 piggyback trailers under long-term leases which expire at various dates to 1971. Current annual rentals under the various leases amount to approximately \$835,000. Certain of these leases provide options to purchase or to renew rentals for substantially lower amounts after the initial terms. The company also rents its general offices under a lease expiring in 1972, renewable thereafter, which provides for a current annual rental of about \$280,000.

The company is plaintiff or defendant in numerous lawsuits which, in the opinion of company officials and counsel, will not have a material effect on its financial position. Several pending proceedings are derivative stockholders' suits arising out of actions pending against one present and two former officers and a former director of the company. Recovery, if any, in these actions would inure to the benefit of the company.

OPINION OF INDEPENDENT ACCOUNTANTS

TO THE BOARD OF DIRECTORS AND STOCKHOLDERS OF THE
BOSTON AND MAINE CORPORATION

We have examined the balance sheet of the Boston and Maine Corporation and its consolidated subsidiaries at December 31, 1965 and the related statements of income and retained income for the year then ended. Our examination was made in accordance with generally accepted auditing standards and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

The depreciation reserves for roadway and structures, accumulated under accounting practices prescribed by the Interstate Commerce Commission as briefly explained in Note 2 of the notes to financial statements, are substantially less than reserves which would have resulted from a systematic method of depreciating the cost of all such properties from the time they were acquired. This deficiency, the amount of which is presently indeterminable, has been augmented by the fact that the reserves which have been provided have been substantially reduced or, for certain classes of assets, eliminated entirely by charges for retirements which have been unusually large in recent years. We have concluded that neither the current depreciation rates for property for which depreciation is being provided nor the "replacement" accounting method for rails, ties, etc. described in Note 2, provide adequately for retirement losses or obsolescence of the magnitude experienced by this railroad.

In our opinion, except for the inadequacy of provisions for depreciation and obsolescence discussed in the preceding paragraph, the financial statements referred to above present fairly the financial position of the Boston and Maine Corporation and its consolidated subsidiaries at December 31, 1965 and the results of their operations for the year, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

PRICE WATERHOUSE & CO.

Boston, Massachusetts
February 28, 1966



